FILED
JUL 29 1992
OFFICE OF THE CLERK

No. 91-321

In the Supreme Court of the United States

OCTOBER TERM, 1992

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Writ of Certiorari to the Supreme Court of Tennessee

REPLY BRIEF OF PETITIONER

PHILIP W. COLLIER
Counsel of Record
JAMES C. SEIFFERT
T. MORGAN WARD, JR.
Stites & Harbison
600 West Main Street
Louisville, KY 40202
(502) 587-3400

ANDREW L. FREY
CHARLES ROTHFELD
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

LISA D. LEACH
Vice President & General Counsel
Itel Containers International Corporation
550 California Street
San Francisco, CA 94104-1006
(415) 984-4508

Counsel for Petitioner

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

BEST AVAILABLE COPY

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
ARGUMENT	1
I. THE TENNESSEE TAX IS PREEMPTED	1
A. The Conventions Apply to Domestically Owned Containers	1
B. The Tennessee Tax Is Inconsistent With the Uniform Practice of Convention Signatories	6
C. The Conventions Are Not Limited to the Proscription of Taxes That Discriminate Between Imports and Other Goods	11
D. The Tennessee Tax Frustrates the Purpose of the Conventions	13
II. TENNESSEE'S TAX VIOLATES THE FOREIGN COMMERCE CLAUSE	14
A. The Tennessee Tax Fails the "One Voice" Test	15
B. The Tennessee Tax Raises the Prospect of Impermissible Multiple Taxation	16
C. Sales Taxes May Violate the Foreign Commerce Clause	18
III. TENNESSEE'S TAX VIOLATES THE IMPORT-EXPORT CLAUSE	19
CONCLUSION	20

TABLE OF AUTHORITIES

CASES: Page

Canton R. Co. v. Rogan, 340 U.S. 511 (1951) 19-20
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 18
Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 17-18
First Agricultural Nat. Bank v. State Tax Comm., 392 U.S. 339 (1968) 15
Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) 8, 13, 16, 18
Kamen v. Kemper Financial Services, Inc., 111 S.Ct. 1711 (1991) 1
Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance, 60 U.S.L.W. 4582 (June 18, 1992) 17
Maximov v. United States, 378 U.S. 49 (1963) 5
McGoldrick v. Gulf Oil Corp., 309 U.S. 414 (1940) 13, 14
Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976) 20
Richfield Oil Corp. v. State Board of Equalization, 329 U.S. 69 (1946) 19, 20
Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc., 773 S.W.2d 252 (Tenn. App. 1989) 15
Wardair Canada, Inc. v. Florida Dept. of Revenue, 477 U.S. 1 (1986) 17
Washington Revenue Dept. v. Association of Washington Stevedoring Cos., 435 U.S. 734, 759 (1978) 20
William E. Peck & Co. v. Lowe, 247 U.S. 165 (1918) 11
Xerox Corp. v. Harris County, 459 U.S. 145 (1982) 13, 14

UNITED STATES CONSTITUTION:

Foreign Commerce Clause, Art. I, § 8, Cl. 3 14-18
Import-Export Clause, Art. I, § 10, Cl. 2 19-20

TREATIES OF THE UNITED STATES:

Customs Convention on Containers, May 18, 1956, [1969] 20 U.S.T. 301 ..... *passim*

TABLE OF AUTHORITIES—Continued

Page

Customs Convention on Containers, Dec. 2, 1972, [1985] 988 U.N.T.S. 43 ..... *passim*

FEDERAL STATUTES:

19 U.S.C. § 1322(a) 14

FEDERAL REGULATION:

19 C.F.R. 10.41a 5, 13

TENNESSEE STATUTES:

Tenn. Code Ann. 67-6-313(f) (1989) 17
Tenn. Code Ann. 67-6-502 (1990) 15
Tenn. Code Ann. 67-6-507 (1990) 17

MISCELLANEOUS:

Br. of Asia North America Eastbound Rate Agreement, *et al.* as *Amicus Curiae* 8
Br. of Institute of International Container Lessors as *Amicus Curiae* 8
Br. of Pacific Merchant Shipping Association, *et al.* as *Amicus Curiae* 8
Br. of the United Kingdom as *Amicus Curiae* 12, 16
Consumption Tax Law (Japan) 7
Excise Tax Act, R.S.C. 1985 (Canada) 7
34 Fed. Reg. 1951 (Feb. 11, 1969) 2
General Agreement on Tariffs and Trade (GATT) 8-9
H.M. Customs and Excise Notice 748, Concession B3 (Jan. 1, 1991) 10
O.J. European Comm. (No. L 145) (1977) (Sixth Directive, 77/388) 8-10
O.J. Euro. Comm. No. L134, Council Regulation (EEC) No. 1224/80 9
Presidential Proclamation No. 4707 (Dec. 11, 1979) 14
Regulation 50, Value Added Tax (General) Regulations 1985 S.I. 1985 No. 886 ..... 9, 10
Tariff Schedules of the United States 14
Treas. Dec. 69-146 2

TABLE OF AUTHORITIES—Continued

	Page
U.N. Doc. E.CONF. 59/16 (Nov. 26, 1971)	3, 6
U.N. Doc. E/CONF. 59/IPG.2 (Feb. 14-18, 1972)	6
U.N. Doc. E/CONF. 59/C.2/L.7 (Nov. 15, 1972)	4
U.N. Doc. E/ECE/TRANS/WP24/3 (Dec. 20, 1951)	12
U.S. Br. in Support of Prob. Jur., No. 77-1378	12
Value Added Tax Act 1983 (United Kingdom)	7-10

REPLY BRIEF OF PETITIONER

Neither respondent nor its *amicus* offers any substantial reason to reject the positions advanced by Itel in its opening brief. The Solicitor General premises virtually all of his contentions relating both to the Conventions and to the Foreign Commerce Clause on the proposition that the nations of the European Community impose taxes on the transfer of containers. But this submission—which would require the Court to conclude that the United Kingdom and the 13 other nations that have protested Tennessee's tax do not understand the operation of their own tax laws (since our opening brief was filed, Belgium, Greece, and Portugal have joined in protesting the tax)—is insubstantial on its face. For its part, respondent does not deny that Tennessee is the *only* jurisdiction among the Convention signatories (and their political subdivisions) that taxes the transfer of containers. In these circumstances, the Tennessee tax cannot stand.

ARGUMENT

I. THE TENNESSEE TAX IS PREEMPTED

A. The Conventions Apply to Domestically Owned Containers

The United States begins its discussion of the Container Conventions with the wholly novel argument that the Conventions "are inapplicable to the domestic taxation of domestically owned containers." Br. 8. This contention was not considered by the court below, was not made by the Solicitor General at the certiorari stage, and is not endorsed by respondent; it accordingly cannot be interjected into the case by an *amicus* now. See, *e.g.*, *Kamen* v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711, 1716-1717 n.4 (1991). The argument is, in any event, without substance.[1]

[1] The Solicitor General takes issue with our submission that the 1956 Convention was implemented in the United States by statute

a. The Solicitor General's argument is hinged on Article 3(2) of the 1972 Convention. That article provides that each signatory nation "reserves the right not to grant temporary admission"—which is elsewhere defined to mean admission free of all duties and taxes—"to containers which have been the subject of purchase, hire-purchase, [or] lease * * * concluded by a person resident or established in its territory." But this language merely reserves to signatories the right to deny tax-free admission to containers that their residents *acquire* by lease or purchase outside the jurisdiction for use *in* the jurisdiction.[2] Nothing in the language otherwise alters the general requirement under the Conventions that "each Contracting Party shall grant temporary admission to containers, whether loaded with goods or not," when those containers are in use as instruments of international commerce. 1972 Convention Art. 3(1), 988 U.N.T.S. at 45. See 1956 Convention Art. 2, 20 U.S.T. at 304.

---

and regulation. U.S. Br. 8. His argument is not correct. It is true, of course, that the United States exempted containers from the payment of Customs duty prior to its accession to the 1956 Convention. But federal law *was* changed "to implement the Conventions in respects not previously authorized under domestic law." Treas. Dec. 69-146 (referring to Pub. L. No. 90-635 (Oct. 24, 1968), which exempted repair components from duty). Similarly, the Treasury Department amended 19 C.F.R. 10.41a "in order to conform the Customs Regulations to * * * implement the * * * Customs Conventions." 34 Fed. Reg. 1951 (Feb. 11, 1969) (among other things, adopting the definition of the term "container" supplied by the Convention). The regulations cited by the Solicitor General (at Br. 10) state only that domestically-manufactured containers may be used in domestic commerce, and that payment of the duty frees foreign-origin containers for use in domestic commerce; they say absolutely nothing about the application of the Conventions to temporarily admitted containers that are not used in domestic commerce at all.

[2] While the term "lease" arguably is ambiguous in this regard (since both the lessor and the lessee "lease" the property), that is not true of the terms "purchase" and "hire-purchase," which describe only action taken by the acquiring party.

The Solicitor General's argument does violence to more than the language of the 1972 Convention; it also is inconsistent with both the 1972 Convention's background and the United States' longstanding interpretation of both Conventions. The second sentence of the 1956 Convention's Art. 2 (emphasis added), the predecessor of the 1972 Convention's Art. 3(2), provides that "[e]ach Contracting Party shall retain the right to withhold [temporary admission] in the case of containers which are *imported on purchase or otherwise taken into effective possession and control* by a person resident or established in its territory." The intent of this provision is plain: it was designed to subject containers to import duties upon their first entry into the taxing nation when they were obtained abroad and then brought into the jurisdiction as articles of trade, rather than as instrumentalities of international commerce.

In 1971, when the new draft Convention proposed including a slightly revised version of the 1956 Article 2, the United States objected, noting that "several Contracting Parties are applying this provision in such a way as to charge duty on containers purchased by resident operators upon first temporary importations"—that is, after they had become instrumentalities of international commerce. United Nations Doc. E/CONF. 59/16 at 2-3 (Nov. 26, 1971). The United States went on to explain that

> [t]he United States of America, *under both the [1956] Convention* and its internal regulations, allows duty free temporary importation upon first temporary entry *regardless of the residence of the owner.* Accordingly, the application of this provision by other contracting parties militates against purchase of US-made containers by operators resident in those countries.

Id. at 3 (emphasis added).

The next year the United States renewed its objection to Article 3(2). It explained:

> Acting under the provisions of the second sentence of article 2 of the 1956 Customs Convention, a provision

> carried forward as paragraph 2 in article 3 of the draft revised Convention, *some Contracting Parties charge duties and taxes on resident-owned foreign-built containers upon first importation even though they are in fact, being temporarily imported* * * *. *This approach appears to be inconsistent with the interest of the Convention.*

United Nations Doc. E/CONF. 59/C.2/L.7 at 4 (Nov. 15, 1972) (emphasis added). The provision nevertheless was included in the final version of the 1972 Convention.

There are several points to be taken from this history. First, the Solicitor General is wrong in asserting (at Br. 8-9) that resident-owned containers are exempted from United States Customs duty by statute and regulation rather than by the Conventions; more than 20 years ago the United States made clear that the exemption follows "under *both* the [1956] Convention and [the United States'] internal regulation." Second, as reflected in the comments of the United States, there were two competing interpretations of Article 3(2) and its 1956 predecessor—*neither* of which supports the Tennessee tax. Some countries, the United States explained, understood the provision to permit the taxation of "resident-owned foreign-built containers upon first importation," even if such containers were engaged in international trade at the time. The United States, in contrast, was of the view that the Conventions permit the taxation of containers only when they are imported for use in domestic commerce; the broader interpretation was rejected by the United States as, again, inconsistent with "both the Convention and [the United States'] internal regulations." And the broad view, even if correct, has absolutely no bearing here, since Tennessee is not suggesting that it is trying to tax the first importation (either by Itel or its lessees) of foreign-built containers.

At the same time, the Solicitor General's reading of Article 3(2) would render nugatory the provision's language about purchase, hire-purchase, lease, and the like.

Moreover, an interpretation that generally permits the taxation of all containers owned by domiciliaries of the taxing jurisdiction implicates the very concerns that underlay the United States' objection to Article 3(2): it would discourage the use of American-owned containers in favor of those owned by foreign domiciliaries.

b. It bears emphasis that preemption would be in order even if our reading of Article 3(2) were incorrect and the provision were intended to permit, in specified circumstances, the taxation of all containers owned (or sold or leased) by domestic sellers and lessors. Article 3(1) provides that each Contracting Party *shall grant* temporary admission to containers; article 3(2) then provides that "[e]ach Contracting Party *reserves the right* not to grant temporary admission" to specified containers. Plainly, these provisions confer tax immunity upon containers *unless* the signatory nation exercises its reserved right. Of course, the right is that of the Contracting Parties, not subnational units such as Tennessee. In this case, the United States has not exercised its reserved right either expressly or impliedly (the United States, after all, grants temporary admission to *all* containers engaged in foreign commerce, whatever the domicile of their owners (see 19 C.F.R. 10.41a(1)); the Solicitor General does not claim otherwise. The Tennessee tax accordingly cannot be reconciled with the plain terms of the Convention.[3]

c. Finally, the Solicitor General's insistence that the Conventions do not apply to domestic taxation of Itel's domestically owned containers is contrary to the history

---

[3] *Maximov v. United States*, 373 U.S. 49, 52-56 (1963), cited by the United States at Br. 9, is simply off the point here. That case involved a bilateral convention intended to avoid duplicative taxation by reserving to each of the two contracting nations the right to impose a full measure of income tax upon its residents. It hardly stands for the proposition that international conventions invariably do not address how signatories will deal with their own residents. The other bilateral treaties cited by the United States at Br. 9 n.5 are similarly irrelevant.

and purposes of the Conventions. The signatories to the Customs Conventions did not contract merely to receive the reciprocal benefit of temporary admission in other countries. They sought, and now enjoy, the "significant economic benefits to the development and facilitation of international container traffic on a global basis" that follow from the tax-free movement of containers. U.N. Doc. E/CONF. 59/16 at 2 (Nov. 26, 1971). Indeed, President Johnson's stated purpose in recommending adoption of the 1956 Convention was to "aid the American export drive." See Pet. Br. 18. As a Contracting Party to the Conventions, the United States is obliged to participate in the "uniform facilitation of container traffic to the benefit of the international system." U.N. Doc. E/CONF. 59/IPG.2, Annex at 15 (First Meeting, Feb. 14-18, 1972).

B. The Tennessee Tax Is Inconsistent With the Uniform Practice of Convention Signatories

The United States' other principal argument concerning the Conventions—one that is not endorsed by respondent—is that the United Kingdom and the other EC countries themselves impose sales tax equivalents on containers. Neither the Solicitor General nor respondent deny that it would be highly relevant to the interpretation of the Conventions if other signatories withheld their taxes. Instead, the Solicitor General makes the remarkable assertion that the United Kingdom (and the other EC countries that have protested Tennessee's tax) misunderstand the operation of their own tax laws. Needless to say, this assertion is inherently implausible. Indeed, the United Kingdom has filed a diplomatic note with the State Department taking specific issue with the representations relating to British law made by the Solicitor General in his brief; the note reports that the government of the United Kingdom explained the operation of its tax laws to the United States and anticipated that "its response would put to rest any doubts that the U.K. does not tax the lease proceeds of containers dedicated to international trade * * *." Diplomatic Note, July 27, 1992 (a copy of the note is appended to this brief).[4] The United Kingdom is correct.

a. The Solicitor General erroneously equates a value added tax ("VAT") paid by an ultimate consumer of *goods* imported in a container with Tennessee's sales tax imposed directly *on* the container. The Solicitor General reasons that the "container lease is indirectly subjected to the VAT" (Br. 15 n.11) because the "value of imported goods is defined for purposes of the VAT * * * to include the price of the imported goods *plus* the cost of transport of those goods to the importing destination." Br. 14-15.[5] This argument confuses two entirely distinct concepts: the taxation of containers with the taxation of goods carried *by* container. Itel does not contend that for sales tax purposes Tennessee cannot include incidental transport costs (including the cost of container use) in calculating the value of goods sold in the state. In such circumstances it is irrelevant to the shipper, the vendor, and the ultimate taxpayer (the Tennessee consumer who ultimately purchases the goods at retail) that the cargo was transported in a container rather than by some other method.

But the Tennessee tax here does not merely factor in the contribution of the container in setting the value of goods transported *in* the container; it taxes the container

---

[4] The Solicitor General addresses his argument only to tax laws of the EC nations. He rightly does not suggest that any other nation imposes a container tax. To give just two examples, Article 17(2)(ii) of the Cabinet Order promulgated under Japan's Consumption Tax Law exempts from tax "[t]ransactions involving the transfer or leasing of containers used for the transportation of freight mainly between domestic and foreign areas or between two foreign areas." (The translation is unofficial). And Canada exempts containers used in international commerce from its federal sales tax. See Excise Tax Act, R.S.C. 1985, § 213, Schedule VII.

[5] The Solicitor General's argument relies on Sixth Directive art. 11(B)(3)(b), which requires that the taxable value of imported goods include not only the price paid by the importer, but also other charges, "including 'incidental expenses, such as commission, packing, transport and insurance costs.'"

itself. The levy falls directly on the container lessor and lessee, adding an expense *because* the goods are being transported by container. Unlike the U.K. VAT paid by the ultimate consumer of goods shipped in a container,[6] Tennessee's sales tax imposed on the leased container directly discourages steamship lines from using containers in international trade, frustrating the very purpose of the Conventions—"remov[ing] impediments to the use of containers as 'instruments of international traffic.'" *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 453 (1979). By contrast, including the cost of container transport as a factor in valuing goods does not impose special disincentives on the use of containers as against other means of cargo shipment.

b. That the inclusion of transport costs in valuing the transported goods does not amount to a tax on containers within the meaning of the Conventions is dispositively confirmed by international practice relating to the calculation of Customs duties. The same valuation method employed for the VAT is authorized for Customs duty purposes by Article VII of the General Agreement on

[6] The Solicitor General's example of the imposition of the U.K.'s VAT upon goods carried in containers (see Br. 15 & n.11), is not supported by the record, commercial reality or the U.K.'s VAT statutes. A London importer will not itself lease a container in Tennessee. Itel and all container lessors lease containers to international steamship lines; exporters, importers and ultimate purchasers of the goods carried in containers are not container lessees. Stip. 71, Pet. App. 34a; Ex. 13; Tr. 38, 40-42, 60; Amicus Br. of the Institute of International Container Lessors, *et al.* at 2, 4-5; Amicus Br. of Pacific Merchant Shipping Association, *et al.* at 1, 9, 13; Amicus Br. of Asia North America Eastbound Rate Agreement, *et al.* at 4. Thus, the government's example at page 15 is inapposite. In addition, the Solicitor General incorrectly implies that the fictional London importer pays the VAT imposed on the value of the goods carried in the container. Because of the input/output tax aspect of the VAT regime, the importer does not pay any net VAT on the goods; the VAT only "adheres" to the ultimate consumer of the goods. O.J. European Comm. (No. L 145) art. 17(2)(a)(1977) (Sixth Directive 77/388); Value Added Tax Act 1983c 55 §§ 14, 15.

Tariffs and Trade (GATT);[7] indeed, the VAT on the importation of goods is "charged and payable as if it were a duty of customs." U.K. Value Added Tax Act 1983 (c 55), § 2(4). Pursuant to GATT Article VII, the United Kingdom and other signatories to both GATT and the Conventions include transportation costs in the dutiable value of imported goods. O.J. European Comm. (No. W34), art. 8, Council Regulation (EEC) No. 1224180. If the Solicitor General is correct in his argument that the VAT imposed on the ultimate consumer of imported goods really is a tax on the container lease (because the price of the goods includes a component representing transport costs), these GATT signatories impose prohibited Customs duties upon containers *every time* that they receive a shipment of goods in a container. Such an understanding, which would render the Conventions meaningless, cannot be correct.

c. It is plain moreover, that no EC VAT attaches to any temporarily-imported container *qua* container and that no EC transaction tax or ad valorem tax is paid or collected by the parties to container lease or sale transactions—and neither the Solicitor General nor respondent contends to the contrary. Thus, if the transactions that gave rise to the Tennessee tax had occurred in the EC, no VAT would have been paid upon the transfer of the container leases. Leases of transport equipment directly linked to the transit or export of goods are exempt from tax.[8] Similarly, a container leased by a U.K. shipping company exclusively for international transport from a lessor established outside the U.K. would

[7] Agreement on Implementation of Article VII of the GATT (GATT Customs Valuation Code), Pt. I, Article 8(2) provides that "[i]n framing its legislation, each Party shall provide for the inclusion in or the exclusion from the customs value, in whole or in part, of the following: (a) the cost of transport of the imported goods to the port or place of importation."

[8] Sixth Directive, art. 15(13); Regulation 50, Value Added Tax (General) Regulations 1985, S.I. 1985 No. 886 (a supply of a container for export is "zero rated").

bear no VAT; no VAT is charged on a supply from a foreign source when the same supply would not have been taxed if obtained from a U.K. supplier. See Value Added Tax Act 1983 (c.55) § 7; Regulation 50, *supra*, n.8. In addition, the container lease may be exempt from VAT if the container enters an EC country loaded with imported goods.[9] Finally, the UK and the other EC nations clearly exempt containers from the ad valorem VAT levied upon the importation of goods.[10]

d. The United States also notes that it and other nations impose taxes on the net income of container lessors and asserts that "[p]etitioner offers no explanation why *income* taxation applied to such containers is permitted

[9] Sixth Directive, art. 14(1)(i), provides that member states are required to exempt "the supply of services, in connection with the importation of goods where the value of such services is included in the taxable amount in accordance with Article 11B(3)(b)." The Solicitor General contends that this provision insures that container transfers "are subject to the VAT at least once." Br. at 17 (emphasis omitted). This is incorrect. The regulation "exempts" supplies of services (i.e., leases) "in connection with the importation of goods" while insuring that the importer includes the cost of the lease within the taxable value ultimately paid by the consumer upon the goods carried in the container under Art. 11B(3)(b). The Article 14(1)(i) exemption applies only to the lease of containers that are imported loaded; no VAT is paid or collected by a container lessor or lessee where a container is leased abroad and imported empty. In addition, a container leased within the UK for transit or export is exempted from the VAT under Art. 15(13), not 14(1)(i).

[10] Sixth Directive, art. 14(1)(c), provides that member states are required to exempt the "importation of goods declared to be under temporary importation arrangements, which thereby qualify for exemption from customs duties, or which would so qualify if they were imported from a third country." Itel's containers qualified for temporary admission under the Conventions. The United Kingdom implements this directive by waiving VAT on "containers which are temporarily imported for emptying or filling and subsequent re-exportation." HM Customs and Excise Notice 748, Concession B3 (Jan. 1, 1991).

but *revenue* taxation is not." Br. 14 (emphasis in original). In fact, the explanation is manifest in both the language and policy of the Conventions. As we explain in our opening brief (at 13-14), sales taxes are imposed "in connexion with" or "by reason of" importation because they are made possible by the container's entry into the taxing jurisdiction. That is not true of income taxes, which have nothing to do with whether any or all containers ever move into or leave the taxing nation.

At the same time, excepting container lessors from income taxes would lower shipping costs only in a very indirect sense (and would not do so at all if lessors failed to pass on the increased profits to lessees). In contrast, the taxation of individual container transactions—particularly in the form of a levy that, under Tennessee law, must be passed on to the container lessees—directly increases the cost of container transport. Indeed, the Court recognized precisely this distinction in a closely related setting involving federal income taxation of exporters:

> At most exportation is affected only indirectly and remotely [by an income tax]. The tax is levied after the exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he pleases.

William E. Peck & Co. v. Lowe, 247 U.S. 165, 175 (1918).

C. The Conventions Are Not Limited to the Proscription of Taxes That Discriminate Between Imports and Other Goods

The Solicitor General and respondent argue that Tennessee's sales tax is not imposed "in connexion with" or "by reason of" importation, contending that the Conventions proscribe only taxes that distinguish between goods of domestic and foreign origin. U.S. Br. 12-13; Resp. Br. 26. In support of this proposition the Solicitor General cites a list of wholly inapposite decisions involving, not the Conventions, but the Commerce and Import-Export Clauses. U.S. Br. 12. But the Conventions, of

course, make no such distinction. To the contrary, the 1972 Convention excepts from its proscription of taxes "fees and charges limited in amount to the approximate cost of services rendered." That exception plainly contemplates wharfage and user fees that do not depend upon the container's point of origin—and the exception's presence in the Convention makes clear that such generally applicable taxes are proscribed except when specially permitted.[11]

In addition, of course, any ambiguity here should be resolved by looking to the uniform understanding of Convention signatories. As the United Kingdom explains in its *amicus* brief, and as many of our trading partners explain in the diplomatic note submitted to the Department of State, Itel's reading of the Conventions' terms is generally shared by participants in the Conventions. Indeed, the views of the United Kingdom and of several of the other nations protesting Tennessee's tax (Belgium, France, Germany, Italy, the Netherlands, and Sweden) are due special deference in this regard because those nations constituted a majority of the Economic Commission for Europe Inland Transport Committee working party on containers, which prepared the 1956 Convention. UK Br. App. 1a, Ex. 21; UN Doc. E/ECE/TRANS/WP24/3 (Dec. 20, 1951).[12]

---

[11] Indeed, in its brief to this Court in *Japan Line*—in which it argued that California's generally applicable property tax was preempted by the 1956 Convention—the United States noted that "'[f]ees that are related to the value of specific services provided to vessels and containers * * * are * * * permissibly charged under the custom of nations." No. 77-1378, U.S. Br. 15 n.7. The United States indicated that such fees include "wharfage fees and other similar user charges." *Id.* at 23 n.12. The exception to the 1972 Convention presumably was added to take account of this custom.

[12] Respondent (at Br. 27-31) cites the history of the 1956 Convention in arguing that it prohibits only traditional Customs duties. See also U.S. Br. 13 n.8. In addition to being flatly inconsistent with the language of both Conventions (see Pet. Br. 12-13), however, this argument runs up against the understanding of the nations involved in the creation of that history.

D. The Tennessee Tax Frustrates the Purpose of the Conventions

In our opening brief we explain that the Conventions were designed to facilitate the use of containers. Pet. Br. 17-21. We also note that state taxes on the transfer of containers, which add expense to the use of containers and therefore discourage container traffic, would frustrate that purpose; in *McGoldrick* and *Xerox* the Court held state taxes preempted in directly analogous circumstances. See Pet. Br. 21-27. Neither the Solicitor General nor respondent make any serious attempt to respond to those points.

To the contrary, while the Solicitor General acknowledges that "the scope of the preemption resulting from a customs bond must be determined by analysis of the 'congressional intent' in providing bonded admission" (Br. 20, quoting *Xerox*, 459 U.S. at 153), he never so much as hints at what the purpose of the Conventions (or of the Senate's intent in ratifying them) might be. In fact, that purpose is announced in the text of the Conventions and (notwithstanding the Solicitor General's assertion to the contrary at Br. 19) was stated by the Court in *Japan Line:* they "reflect[] a national policy to remove impediments to the use of containers." 441 U.S. at 453. The Solicitor General fails to explain why a state tax on the transfer of containers does not constitute such an impediment.

Curiously, the Solicitor General does assert that the "benefit conferred by the exemption 'from *federal* Customs duties' exists independently of the Tennessee tax and is not altered or reduced by that tax." Br. 19 (emphasis in original).[13] It certainly is true that Tennessee

---

[13] The Solicitor General also appears to suggest that Itel did not benefit from the waiver of federal Customs duties during 1983-1986. U.S. Br. 18 n.14. Itel, of course, did not pay any Customs duties upon the importation of its containers because the containers were temporarily admitted into the United States under Customs bond as provided by the Conventions and 19 C.F.R. 10.41a. The Solicitor General contends that since Congress, beginning in 1983,

does not purport to impose or collect federal duties. Neither, however, did the States whose levies were challenged in *McGoldrick* and *Xerox*, where the Court invalidated state sales and property taxes precisely because the taxes imposed burdens of the type waived at the federal level by Congress. Those holdings are dispositive here.[14]

II. TENNESSEE'S TAX VIOLATES THE FOREIGN COMMERCE CLAUSE

The principles that govern application of the Foreign Commerce Clause are not in dispute. Neither the Solicitor General nor respondent takes issue with the proposition

---

had temporarily suspended payment of duty on certain intermodal freight containers "having a gross mass rating of at least 40,000 pounds," Itel did not save any Customs duties by entering its containers under bond. The fact remains, though, that Congress waived the collection of Customs duties upon the importation of Itel's containers both to implement the protection provided by the Conventions and to accelerate implementation of international agreements reached by the United States through the Multilateral Trade Negotiations concluded in 1979. The Solicitor General's argument simply misses the point: absent explicit congressional action, the Tariff Schedules of the United States would have required Itel to pay duties of approximately $178,550; Tennessee's revised sales tax assessment of $158,012 substantially offsets that exemption. TSUS 640.30; Presidential Proclamation No. 4707 (Dec. 11, 1979, § A, Schedule 6, Part 2.

[14] For its part, respondent emphasizes a perceived difference between the pervasiveness of federal customs warehouse regulation on the one hand and container regulation on the other. Resp. Br. 34-35. While offering an extensive discussion of the customs warehouse regulations, however, respondent focuses its discussion of federal container regulation entirely on the statute authorizing Customs duty exemptions for instruments of international traffic, 19 U.S.C. § 1322(a); Tennessee simply ignores both the Conventions themselves and the substantial body of regulation administered by the Department of Treasury and the Customs Service, which is summarized in Itel's opening brief at 25 n.18. And while arguing that the Conventions and the bonded warehouse statutes serve different purposes (Resp. Br. 34-35), respondent fails to address the question whether the purposes served by the Conventions are frustrated by its tax. See Pet. Br. 24-25.

that a state tax must fall when it raises the prospect of retaliation from abroad by creating an asymmetry in international taxation. Both the Solicitor General and respondent also appear to recognize that (at least in some circumstances) the Commerce Clause precludes the imposition of state levies that raise a substantial risk of duplicative taxation. Application of these principles here is fatal to the Tennessee tax.

A. The Tennessee Tax Fails the "One Voice" Test

Respondent does not deny that the bulk of Itel's customers are steamship companies that are domiciled abroad. It nevertheless insists that "[n]o rational foreign government would retaliate against" the tax imposed upon Itel. Br. at 39. To support this surprising assertion, the State submits that Itel (and presumably the United Kingdom and the thirteen other nations that have protested the tax) "misunderstand[] the legal effect of Tennessee's tax" because the legal incidence of the levy falls upon the seller/lessor and "is not imposed on foreign nationals or foreign interests as such." Br. 38.

Simply put, this argument mischaracterizes the Tennessee tax. While respondent observes that "provision is made for Itel, if possible, to pass on the tax to its customers" (Br. 38), state law in fact *requires* that the tax be separately stated on the bill submitted to the lessee and that the tax be "collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. 67-6-502. See Pet. Br. 37-38. And despite the State's "legal incidence" argument, the Tennessee courts have held that "the burden for the payment of the [sales] tax is meant to be that of the buyer." *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-255 (Tenn. App. 1989). See *First Agricultural National Bank v. State Tax Commission*, 392 U.S. 339, 347 (1968) ("a sales tax which by its terms must be passed on to the purchaser imposes the legal incidence of the tax upon the purchaser"). Because the tax thus creates an asymmetry in international taxation that burdens foreign in-

terests—neither respondent nor the Solicitor General suggests that *any* foreign nation imposes taxes on American container lessees that relate to container transfers [15]—the Tennessee tax cannot stand. See *Japan Line*, 441 U.S. at 453.

For his part, the Solicitor General is now conspicuously silent regarding the prospect of foreign retaliation. In contrast, when he opposed Itel's petition for a writ of certiorari he contended that Itel's argument concerning the prospect of retaliatory taxation by other nations "lack[ed] any support" because he had not been advised by the Department of State that any "foreign government has protested, or threatened retaliation against, application of Tennessee's sales tax to transactions involving containers used exclusively in foreign commerce." U.S. Br. in Opp. 7 n.7. Since that time, of course, fourteen of our principal trading partners have objected to the Tennessee tax and the United Kingdom has informed the Court that it and other signatories to the Conventions "are not likely to tolerate a situation in which they refrain from imposing taxes while U.S. political subdivisions impose theirs." U.K. Br. 10-11. This places the prospect of retaliation—and thus the unconstitutionality of Tennessee's tax—beyond dispute.

B. The Tennessee Tax Raises the Prospect of Impermissible Multiple Taxation

As for the second element of the Foreign Commerce Clause test, the Solicitor General acknowledges that Tennessee's tax creates a real risk of multiple international taxation because "the United Kingdom and other European Community Nations may also apply their sales tax equivalent—or VAT—to the lease of the same containers." U.S. Br. 22-23.[16] He nevertheless insists that the bald risk of duplicative taxation does not suffice to invalidate a state tax on foreign commerce because, if it did, all state taxation of goods destined for export would be unconstitutional.

[15] While the Solicitor General of course contends that the values of container leases are taxed by the EC nations under their VATs, those taxes are paid by the ultimate purchasers of the goods carried in the containers, not by the container lessees (or lessors). In any event, as we explain above, the Solicitor General is simply incorrect in asserting that the EC nations do tax the transfer of containers. And because foreign container lessors are subject to the tax in Tennessee—as we noted in our opening brief (at 37 n.26) and as respondent does not deny—the state tax, even if borne entirely by the lessor, would for that reason create a risk of retaliation by creating an asymmetry in international taxation to the disadvantage of foreign nations, which do not tax sales or leases made abroad by American container lessors.

We agree with this statement, as far as it goes; we do not contend that foreign commerce should in all respects be immune from state taxation. Instead, we maintain only that state taxation is unconstitutional in those circumstances identified by the Court in *Container Corp.*, where it explained that the scrutiny "of double taxation in the foreign commerce context * * * must take into account the context in which the double taxation takes place and the reasonable alternatives available to the taxing State." 463 U.S. at 189. The Court explained further that the *Japan Line* tax had been invalidated because the State there "could [have] entirely eliminate[d] one important source of double taxation simply by adhering to one bright-line rule: do not tax, to any extent

[16] Somewhat inconsistently, the Solicitor General (at U.S. Br. 21-22)—as well as respondent (at Resp. Br. 19)—cite this Court's decision in *Wardair* for the proposition that sales taxes cannot pose the risk of multiple taxation. We explain in our opening brief (at 31-32) why *Wardair* stands for no such proposition; neither the Solicitor General nor respondent so much as addresses the points made in our opening brief. In addition, respondent's assertion that there can be no duplicative taxation here is belied by its own tax scheme: Tennessee itself recognizes the equivalence between its sales tax and compensating use taxes by providing a use tax credit for sales or use taxes paid to other States when *interstate* commerce is involved. Tenn. Code Ann. 67-6-313(f) (1989), -507 (1990). Of course, Tennessee does not provide a credit for equivalent *foreign* taxes. Tennessee's tax on foreign-commerce containers thus "discriminates against foreign commerce and therefore violates the Foreign Commerce Clause." *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 60 U.S.L.W. 4582, 4585 (June 18, 1992).

whatsoever, cargo containers 'that are * * * used exclusively in international commerce * * *.'" 463 U.S. at 189-190, quoting *Japan Line*, 441 U.S. at 444. Requiring the State to adhere to this rule "was by no means unfair, because the rule did no more than reflect consistent international practice and express federal policy." *Id.* at 190.

The limiting principle found in the *Container Corp.* decision is equally applicable here. Requiring Tennessee to adhere to the same principle is by no means unfair or impractical: as we explain above, the rule reflects international practice and already is adhered to by all of Tennessee's sister States. Indeed, the Solicitor General advocates the same principle—that a potentially duplicative state tax is unconstitutional when it conflicts with consistent international practice (see U.S. Br. 23-24)—yet insists that there is no such conflict here. As we explain above, the Tennessee tax *does* collide with international practice; the tax therefore violates the Foreign Commerce Clause.

C. Sales Taxes May Violate the Foreign Commerce Clause

Respondent's remaining arguments lack substance. The State devotes considerable attention to distinguishing its sales tax from the property tax at issue in *Japan Line* (Br. 15-18); it does not, however, present any reason why the factual differences between sales and property taxes should have a legal significance under the Commerce Clause. Similarly, respondent's defense of its tax under the internal and external consistency tests (Resp. Br. 20-23) is beside the point. Those tests are used to apply the standard for taxation of *interstate* commerce announced in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). The California tax invalidated in *Japan Line* also passed those tests; it nevertheless was invalidated because the taxation of foreign commerce must survive "a more extensive constitutional scrutiny." *Japan Line*, 441 U.S. at 446. The Tennessee tax cannot survive that scrutiny.

III. TENNESSEE'S TAX VIOLATES THE IMPORT-EXPORT CLAUSE

Neither the Solicitor General nor respondent takes issue with our statement of the governing law under the Import-Export Clause: they do not deny that direct taxes on in-transit exports violate the Clause and do not suggest that the Court's ruling in *Richfield* no longer is good law. Instead, they attempt to avoid application of the controlling law to the facts here. That attempt should be unavailing.

The Solicitor General simply restates the assertion that he made in opposing certiorari (and that the Court presumably considered and rejected when it granted review): that the Import-Export Clause is inapplicable here because "the goods the containers carry are exports, but the containers are not." U.S. Br. 27. This contention is insubstantial. The only authority offered by the Solicitor General for his assertion that containers are not exports, *Canton R. Co. v. Rogan*, 340 U.S. 511 (1951), is self-evidently beside the point. There, the Court upheld a gross-receipts tax on income that a railroad "derived from the *handling* of goods moving in foreign trade." *Id.* at 512 (emphasis added). The tax did not fall on any article that moved in foreign commerce; the tax instead was laid on income derived from services that the railroad provided in the form of switching, storage, wharfage, weighing and unloading. See *id.* at 512-513. Distinguishing *Richfield*, the Court explained that "[t]he difference is that in the present case the tax is not on the *goods* but on the *handling* of them." *Id.* at 514 (emphasis in original). Here, of course, the Tennessee sales tax does not fall upon the service of "hauling" goods, as the Solicitor General seems to suggest (at U.S. Br. 28), but instead is imposed directly on containers that are themselves articles in the stream of foreign commerce.

Indeed, as the Court explained in *Canton*, "[t]o export means to carry or send abroad; to import means to bring into the country." 340 U.S. at 515. Unlike services such as handling containers or the goods carried by container,

containers themselves (*like* the goods they carry) plainly are articles that are "sen[t] abroad" and "br[ought] into the country." *Ibid.* And there is no reason to believe that containers should be treated differently than other exports and imports under the Clause.[17]

For its part, respondent, while offering a lengthy rehearsal of the *Michelin* analysis (Resp. Br. 43-48), also does not assert that a state tax imposed directly on in-transit exports can survive Import-Export Clause scrutiny. Instead, it contends that its tax somehow "falls upon activities distinct from the goods and their value." *Id.* at 48. But the State's argument that its sales tax is a "privilege tax" rather than a "direct tax on the containers themselves" (*ibid.*) was rejected in *Richfield*, where the Court held that a State's characterization of its tax "is not determinative of the question whether the tax deprives the taxpayer of a federal right." 329 U.S. at 84. And respondent's claim that its sales tax is largely unrelated to the value of the underlying property is a nonsensical one that also has been rejected by the Court. "[T]he Court has always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale ha[s] no value or significance apart from the goods." *Washington Stevedoring*, 435 U.S. at 756 n.21. Tennessee's tax, which falls directly on goods in transit, therefore violates the Import-Export Clause.

CONCLUSION

The decision of the Tennessee Supreme Court should be reversed.

---

[17] In addition, the Solicitor General's position makes no logical sense. It cannot be dispositive that containers are used to facilitate the transport of other goods; the same is true of packaging materials, which inarguably may be imports or exports. Nor does it matter that the containers may return to this country; goods that are leased (rather than sold) for use across national borders are treated as imports or exports, even though they will return to the country of origin. And were it not for the Conventions, containers would be treated as imports for purposes of federal Customs duties. The Solicitor General offers no reason to believe that they should be treated differently for purposes of the Import-Export Clause.

Respectfully submitted,

PHILIP W. COLLIER
Counsel of Record
JAMES C. SEIFFERT
T. MORGAN WARD, JR.
Stites & Harbison
600 West Main Street
Louisville, KY 40202
(502) 587-3400

ANDREW L. FREY
CHARLES ROTHFELD
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

LISA D. LEACH
Vice President & General Counsel
Itel Containers International Corporation
550 California Street
San Francisco, CA 94104-1006
(415) 984-4508

Counsel for Petitioner

JULY 1992

APPENDIX

APPENDIX

Note No. 96

Her Britannic Majesty's Embassy presents its compliments to the Department of State and has the honour to refer to the brief for the United States as amicus curiae supporting the respondent in the US Supreme Court in ITEL Containers International Corporation v Joe Huddleston, Commissioner of Revenue of Tennessee.

Her Majesty's Government ("HMG") notes the references in the United States brief to the statements in the brief of the United Kingdom of Great Britain and Northern Ireland, as amicus curiae in support of the petitioner, relating to the applicability of value added tax (VAT) to leases of international commerce containers. The Department of State will recall that following a meeting held at the request of the Department of Justice, HMG provided written responses to a number of questions raised and an explanation as to the way in which the VAT system operates in the UK in the relevant area. A copy of this response is annexed to this Note. HMG believes that its description of UK domestic law should be accepted as authoritative and had expected that its response would put to rest any doubts that the UK does not tax the lease proceeds of containers dedicated to international trade under the 1956 Customs Convention on Containers (20 U.S.T. 301). HMG is surprised and disturbed that, notwithstanding this response, the United States Government ("USG") in its brief should inform the US Supreme Court that HMG's position on this point is "inaccurate and materially incomplete".

HMG would be grateful for a clarification of the position of the USG on this issue, and requests the State Department to draw to the attention of the US Supreme Court the contents of this Note and its annex, copies of which have been made available to the parties to the case.

Her Britannic Majesty's Embassy avails itself of this opportunity to renew the assurance of its highest consideration.

BRITISH EMBASSY

27 JULY 1992

1. This memorandum is being provided by Her Majesty's Government to the US Government at the request of the US Department of Justice which last week presented HMG representatives with a four-page paper stating that the portion of HMG's *amicus* brief regarding the applicability of the VAT to leases of international-commerce containers is incorrect and misleading to the Court. HMG appreciates the opportunity to comment on the DOJ's paper.

2. HMG wishes to inform the DOJ that it disagrees with the conclusion and the analysis set out in the DOJ paper. None of the representations made by HMG in its brief to the Court were lightly made. In particular, the VAT discussion at pages 8-9 is accurate, fair and continues to be the UK position. If the DOJ wishes to challenge before the Court the representations in the UK brief on how the UK VAT relates to containers leases, HMG requests that its responses herein be brought to the Court's attention as well.

3. The central point HMG makes in its discussion of the VAT in the brief is that ". . . HMG views the Convention as precluding the United Kingdom from imposing the 17.5% VAT in circumstances analogous to those under which Tennessee imposes its sales tax: on the leasing of containers dedicated to international commerce while those containers are in temporary import status in the United Kingdom under Convention rules". (UK Brief at 8). That is to say, when a shipping line leases an international-commerce container in the UK,[1] neither the containers lessor nor

[1] By "international-commerce containers in the UK," HMG of course means a container that (a) is dedicated to international commerce as prescribed in the Convention, and (b) is in the UK by reason of its importation under the temporary importation rules of the Convention.

the shipping-line lessee is burdened by the VAT; that result is dictated by the Convention's proscription of taxation on temporarily imported containers.

4. The result is no different when a shipping line leases an international-commerce container in Tennessee and that container, laden or empty, is temporarily imported into the UK. Again, neither the container lessor nor the shipping-line lessee is burdened by the VAT.

5. The VAT situation described in paragraphs 3 and 4 is also the case in the other EC member states as a result of the EC's principal VAT harmonisation directive, the Sixth Directive, which is wholly consistent with the 1956 and 1972 Conventions' prohibition of taxation on international-commerce containers.

6. The DOJ paper does not dispute the fact that unlike the Tennessee sales tax on the proceeds of an international-commerce container lease—which tax first burdens the container lessor but by law must be collected from the shipping-line lessee—the UK VAT burdens neither. Instead, in seeking to counter HMG's representation that the UK (in common with the major trading partners of the US[2]) does not impose any tax burdens on international-commerce container leases, the authors of the DOJ paper rely on the notion that the VAT *is* imposed on a container lease by virtue of the following[3]—

[2] In addition to the eleven nations that are party to the Diplomatic Note appended to the UK brief, HMG understands that three more nations have protested Tennessee's application of its sales tax to the lease of temporarily imported international-commerce containers: Belgium, Greece and Portugal.

[3] The example appearing in the first paragraph 2 of the DOJ paper does not comport with commercial reality. First, a London importer

(a) that a leased container may be used to carry imported goods into the UK;

(b) that the cost of transporting those goods to the UK will include an element attributable to the leased container cost;

(c) that the value of the goods on importation consists of the cost of the goods plus the transport costs;

(d) that the ultimate consumer of the goods in the UK (after all the intermediary steps of processing and distribution have been completed) will pay the market price for the goods inclusive of the VAT;[4]

---

will not itself lease a container in Tennessee. The importer will engage a shipping line to transport the goods to the UK. It is that shipping line which almost invariably will lease the container in accordance with its container fleet requirements. The container lease cost will be one overhead cost incurred in the provision of the transport service offered by that shipping line and reflected in the price of that service, just as vessel costs, wages, stevedoring expenses, fuel costs, costs for inland tranport, and all other shipping line costs are reflected in the freight rate. Second, the $10,000 lease cost for a container leased for one trip from the US to the UK is wildly out of line. The actual lease cost for that one trip (putting aside the fact that a container is rarely leased for a single trip) will be much closer to $100 than $10,000. The hypothetical freight rate of $5,000 is also excessive but, even assuming that rate, it should include as a component part a container lease cost of about $100. The freight rate, then, would also include $5.50 in Tennessee tax on the lease proceeds. The balance of the freight rate ($4,894.50) would then represent all other costs of the shipping line, including a profit element, if any. In the text, HMG will assume these far more realistic circumstances.

[4] Because of the input tax/output tax aspect of the VAT regime, the importer and all intermediaries do not pay any net VAT on the goods; the VAT only "adheres" to the ultimate consumer of the goods since the consumer is not using them in a trade or business. Of course, if the goods are of a type that is relieved from the VAT (e.g., foodstuffs, children's clothing), even the ultimate consumer will not pay it.

(e) that since the price to the ultimate consumer will naturally reflect in some measure all costs in bringing the goods to market, including transport costs, the VAT applied to that price and collected from the consumer will include some tax on the transport and consequently some tax on every cost element that goes into the provision of the transport—the container lease cost being one such element.

From this, the DOJ paper suggests that HMG may have been less than candid with the the Court in stating that the UK and other signatories to the Convention do not tax the lease of containers dedicated to international trade. The suggestion, however, is not warranted.

7. The problem HMG and the other governments have with Tennessee's application of its sales tax to international container leases is that the tax imposes a burden on the use of international-commerce containers. The Convention was meant to facilitate the use of such containers and to prevent the imposition of tax and duty burdens. By assessing the tax on container lessors, to be collected from shipping-line lessees, Tennessee has increased the cost of international trading in contravention of the Convention since the tax is not subject to a credit elsewhere and is not otherwise refundable. The additional cost caused by the tax will be felt throughout worldwide trade. The tax applies no matter where a container is used and no matter what it carries (or, indeed, whether it carries anything). In short, the Tennessee tax is spread indiscriminately among all consumers buying goods transported in leased containers delivered in Tennessee.

8. HMG and the other governments *do not* complain that Tennessee applies its sales tax to goods imported

into the US and sold in Tennessee. The cost of such goods to the ultimate Tennessee consumer naturally includes an element attributable to the transport required to bring the goods from, say, the UK to Tennessee and, to the extent that the shipping line utilizes leased containers, container lease costs are of course a part of the transport element of the price paid by the consumer and taxed by Tennessee. However, taxation on the sale of imported goods is not the same as a tax on the lease of a temporarily imported container and is not therefore violative of the Convention. It is important not to confuse the taxation of imported *goods* with taxation on the supply of the *instrumentality* in which those goods were carried, the international-commerce container.

9. HMG should note at this point that the DOJ paper, in saying that the payment of the VAT by the ultimate consumer in the UK of goods imported into the UK is equivalent to a tax on container leasing, ignores the fact that a container leased in the UK is more likely to carry *exports*—as to which no VAT attaches of course—than imports, and that indeed the container will often be used in trading that involves neither UK exports or UK imports—again, as to which no VAT would attach. Even with respect to a container leased in Tennessee for a period of time exceeding the rare one-trip lease, the container will be used some of the time for purposes other than carrying imports to the UK. Moreover, containers are often temporarily imported into the UK without containing VAT taxable goods (the container might be transported empty because there is an imbalance in the ocean carrier's container fleet, it might contain VAT-exempt goods such as foodstuffs, or it might contain goods temporarily imported for re-exportation in the same or some other form). For these reasons alone, it cannot be said that imposition of the VAT

on the UK consumer of imported goods is the same as imposition of the VAT on the container lease itself. The two are entirely different concepts.

10. More imporantly, the DOJ paper misconstrues the provisions of the Sixth Directive dealing with valuation of imported goods (Article 11B) and similar provisions of the Value Added Tax Act 1983 (Section 11). These provisions essentially require that the value of imported goods at the point of importation must include both the price of the goods and the cost of getting them there. This is not a novel concept; the cost of transport is integral to the value of the goods. If it were not required to include transport costs in the value of imported merchandise, such merchandise would be unfairly and incorrectly priced to the detriment of domestic producers of like goods. The same valuation method is prescribed by Article VII of the General Agreement on Tariffs and Trade. Thus, the United States and all other GATT parties impose customs duty on the value so calculated, ie including transport costs. The purpose of the VAT valuation provisions cited in the DOJ paper is to ensure that the goods are valued correctly. Contrary to the assertion in the DOJ paper, those provisions are not designed to ensure that transport costs "are subject to the VAT at least once".

11. Focusing on customs duty helps make the position clear. As noted in the previous paragraph, the method for valuing imports (on importation) is the same for VAT purposes as for customs duty purposes—that is, the method requires the addition of transport costs (of which any container lease costs are a small part) to the price of the goods. Duty of course is paid on this confined amount, the accurate value of the goods. Customs duty is thus paid on the element of value represented by the transport,

including the container lease cost. If the authors of the DOJ paper were correct that the VAT imposed on the ultimate consumer of imported goods is the same as taxation of the container lease because the price of goods includes container hire as a component of transport cost, they would also have to say, in the customs duty context, that since duty is imposed on the transport cost, duty is also imposed on the container hire component of that cost. Such a position, while logically parallel to the DOJ position taken with respect to the VAT, would render the Convention meaningless. If one thing is incontrovertible it is that the Convention prohibits the imposition of customs duty on temporarily imported containers, including those on lease. But no one would assert that the US, the UK and all other signatories to the Convention impose duty on container leases despite the fact that the dutiable value of the goods includes container lease costs as part of the overall transport costs. Since that cannot be asserted in the customs context, neither should similar assertions be made in the parallel VAT context.

12. The analogy discussed in this paragraph and the next, in which aviation fuel costs are substituted for container lease costs as a component of transport costs, will again illustrate the basic error of the DOJ paper: confusion between a tax directly on a particular thing which is also a constituent element of a freight rate, on the one hand, and a tax on the sale of imported goods at the consumer level. Article 9 of the Air Services Agreement between the US and the UK (Bermuda 2) prohibits a party from imposing national sales or excise taxes on aviation fuel purchased by the other party's designated airlines for use in international air service operations. Practically all bilateral air services agreements contain equivalent provisions. Neither the US nor the UK impose any such tax on fuel; they each refrain from

imposing a national tax on aviation fuel because of their mutual obligations under their air services agreements.

13. Fuel is a principal cost component of the price for air freight service (much more so than container lease cost as a percentage of total ocean transport cost). When air cargo is flown from the US to the UK in a US commercial aircraft, for instance, its value for VAT and customs duty purposes includes the cost of transport, as it must in order to be economically sensible. As noted above, the VAT only adheres to the final purchaser of the imported goods, the consumer. Following the reasoning in the DOJ paper with regard to container leases, it would have to be concluded that, because the VAT on the *goods* is paid by the consumer, the UK and other EC countries in fact impose national taxes on *fuel* and thus violate their air services agreements innumerable times every single day. HMG is confident that the US Government would regard this reading as fanciful.

14. HMG trusts that this explanation will help clarify the issues raised.